

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

CULT AWARENESS NETWORK, INC.,)
)
 Debtor-Appellant,)
)
 v.) Case No. 97 C 80
)
 PHILIP V. MARTINO,)
)
 Trustee-Appellee)

JOHN M. BEAL, HAGENBAUGH &)
 MURPHY, and DAVIS WRIGHT TREMAIN,)
)
 Creditor-Appellants)
)
 v.) Case No. 97 C 416
)
 PHILIP V. MARTINO,)
)
 Trustee-Appellee)

APPEAL FROM IN RE CULT AWARENESS) No. 95 B 22133
 NETWORK, INC.,) Hon. Ronald Barliant

MEMORANDUM OPINION AND ORDER

MARVIN E. ASPEN, Chief Judge:

Debtor Cult Awareness Network ("CAN") and Creditors John M. Beal, Esq., Hagenbaugh & Murphy, and Davis Wright Tremain ("the creditors") have appealed from an order of the bankruptcy court authorizing the sale of certain assets of CAN's bankruptcy estate.¹ Philip V. Martino, in his capacity as Trustee for the debtor, and Steven L. Hayes, the purchaser of the assets, have moved to dismiss the appeal as moot pursuant to 11

¹ For reasons that are not obvious to us, the four appellants have chosen to file two separate appeals, even though their objections to the bankruptcy proceedings are identical (as illustrated by their filing of joint briefs). In essence, this matter involves a single appeal.

U.S.C. § 363(m). For the reasons set forth below, the motion to dismiss the appeal is granted.

I. Background²

Cult Awareness Network is an organization whose stated purpose is "to educate the public about the harmful effects of mind control as used by destructive cults." See CAN Bylaws, art. II (dated November 2, 1986). A number of the people CAN sought to "educate"—particularly members of the Church of Scientology—were unreceptive to its overtures and brought suit against it on a variety of tort and civil rights theories. Some of the plaintiffs in these suits prevailed, and the resulting liability, when combined with CAN's mounting legal costs in other pending cases, forced CAN to declare bankruptcy in October 1995. Initially CAN sought to declare chapter 11 bankruptcy, but when it was unable to fashion an acceptable reorganization plan it voluntarily converted the case to a chapter 7 liquidation proceeding.

On October 16, 1996, Trustee Martino notified CAN, the court, CAN's 20 largest creditors, and other interested parties, of his desire to sell a number of CAN's assets, including a number of intangibles such as its trade name and service marks. See Trustee's Application (filed October 16, 1996). Martino also requested that the court shorten the normal 20-day notice period to five days. See *id.* At a hearing held before Judge Barliant on October 23, no party voiced any objection to this notice period or to the limitation of the notice to the 20 largest creditors.³ See Tr. at 6-15 (October 23, 1996). Accordingly,

² This section sets forth only those facts necessary to provide background for the instant motion to dismiss; many other facts which might be relevant to the underlying appeal are omitted for the sake of brevity.

³ Although no one expressed any objection regarding notice, several parties voiced concerns about Martino's proposed sale of CAN's copyrights. After some discussion, however, the parties present came to an agreement regarding the terms under which the copyrights would be sold. See Tr. at 17-20 (October 23, 1996).

Judge Barilant permitted Martino to proceed with his plan to conduct an auction of the assets identified in the notice. *Id.* at 20. At the subsequent auction, Steven Hayes outbid Cynthia Kissler, CAN's executive director, and acquired the assets for \$20,000. *Id.* at 25. Martino moved the court to authorize this sale.

Before Judge Barilant had a chance to rule on Martino's motion to authorize the sale, CAN decided that notwithstanding its silence at the October 23 hearing it had a number of objections to the manner in which notice of the sale had been provided and in which the sale of the assets had been conducted. See Debtor's Emergency Motion (dated October 30, 1996). In response, Martino argued that CAN, as a chapter 7 debtor, lacked standing to raise any objections to the sale, and that in any event the objections were untimely. Judge Barilant agreed with the Trustee, stating in open court:

I'm going to sign the order, grant the motion to authorize the sale. The principal ground on which I'm relying is that the debtor lacks standing to object to the sale, and no creditor or other party in interest has objected. The possibility that there will be a surplus in this estate is too remote to support standing as a party in interest. The liquidated claims against the estate are far more than the present assets. And only if the debtor prevails on two appeals, having lost in the courts below, will there be even a possibility of a surplus.

Tr. at 2-3 (November 21, 1996). Accordingly, the court entered an order authorizing the sale. The court also entered a finding that the purchaser of the assets, Steven Hayes, had purchased in good faith.

At the end of the hearing, CAN requested that the court stay its order authorizing the purchase pending its appeal. Despite Martino's objection that a party without standing should not be permitted to obtain a stay, the court gave CAN five days to post a \$30,000 bond to protect the purchaser and the estate in the event the delay caused by the stay resulted in a loss to either party. *Id.* at 19. CAN was unable to post the required bond, however, and on November 26 the court authorized the sale of assets that had taken place in October. *Tr.* at 4 (November 26, 1996).

In early December, CAN and several of its creditors filed this appeal of Judge Barliant's authorization of the sale of assets. Their principal substantive arguments are that the notice of sale was inadequate and that the "in gross" sale of CAN's trade name and service marks was impermissible under the Lanham Act. On March 28, 1997, however, we granted Martino's motion to stay briefing of these substantive issues in order to allow the parties to focus on threshold questions such as standing, waiver, and mootness, that were raised in Hayes' and Martino's motion to dismiss. We consider each of these questions in turn.

II. CAN's Standing

The conditions which endow parties with standing to participate in bankruptcy proceedings are more limited than those which suffice to establish Article III standing. *In re Andreucetti*, 975 F.2d 413, 416 (7th Cir. 1992). To have standing to raise objections to an order of a bankruptcy court, or to appeal from the entry of such an order, a party must be "directly and adversely affected pecuniarily" by the order. *Depolster v. Mary M. Holloway Found.*, 36 F.3d 582, 585 (7th Cir. 1994); *In re Andreucetti*, 975 F.2d at 416 (quoting *In re Fondiller*, 707 F.2d 441, 442 (9th Cir. 1983)); *In re El San Juan Hotel*, 809 F.2d 151, 154 (1st Cir. 1987).⁴ In light of this principle, the general rule is that chapter 7 debtors lack standing to object to (or appeal from) orders of the bankruptcy court because the commencement of liquidation proceedings extinguishes any pecuniary interests

⁴ The courts have used slightly different language in evaluating the standing of party to object to an order as compared with the standing of a party to appeal an order: to object, the party must qualify as a "party in interest," while to appeal, a party must qualify as a "person aggrieved" (pecuniarily) by the order. This difference in phraseology appears to make little difference, since both concepts turn on whether the complaining party has a pecuniary interest in the resolution of its complaint. Compare *In re Thompson*, 965 F.2d 1136, 1143 n.12 (1st Cir. 1992) ("A chapter 7 debtor generally is not considered a 'person aggrieved,' as she lacks a pecuniary interest in the 'property of the estate.'"), with *Willemain v. Kivitz*, 764 F.2d 1019, 1022 (4th Cir. 1985) ("[A]n insolvent debtor is not a party in interest and thus lacks standing because he has no pecuniary interest in the distribution of his assets among his creditors.").

they formerly held in the property of the estate. See *In re Thompson*, 965 F.2d 1136, 1143 n.12 (1st Cir. 1992); *In re Schultz Mfg. Fabricating Co.*, 956 F.2d 686, 692 (7th Cir. 1992); *Willemain v. Kivitz*, 764 F.2d 1019, 1022 (4th Cir. 1985); *In re Leux*, 181 B.R. 60, 61 (Bankr. S.D. Ill. 1995).

There is a potentially relevant exception to this general rule, however: if a successful objection to (or appeal from) an order might result in a surplus in the estate at the conclusion of the bankruptcy proceedings, the debtor has standing to object or appeal. See *In re Andreucetti*, 975 F.2d at 417; *In re El San Juan Hotel*, 809 F.2d at 155 n.6; *Willemain*, 764 F.2d at 1022 (quoting *Kapp v. Naturella, Inc.*, 611 F.2d 703, 706-07 (8th Cir. 1979)). A debtor seeking to invoke this exception cannot simply claim that there is theoretical chance of a surplus in the estate, but must show that such a surplus is a reasonable possibility. Cf. *In re Andreucetti*, 975 F.2d at 417 (finding standing for a debtor because there appeared to be a reasonable possibility of a surplus in his estate); *Behling v. M & I Marshall & Ilsley Bank*, 96 B.R. 144, 146 (W.D. Wis. 1988) ("[T]he technical possibility that assets of the estate would accrue to the debtor . . . does not afford standing to a debtor where the bankruptcy estate is insolvent and it is apparent that no estate assets could possibly accrue to the debtor."); *In re Martin*, 201 B.R. 338, 344 (Bankr. N.D.N.Y. 1996) ("To allow [debtors] to have standing based upon the highly speculative conjecture of a surplus . . . would be to open the floodgates for debtors to object to a variety of the Trustee's actions in a case and frustrate the goals of bankruptcy law . . ."). As with all other matters of standing, the burden falls on the debtor whose standing is challenged to provide evidence from which the court could infer the reasonable possibility of a surplus for the estate. Cf. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992) (party invoking federal jurisdiction must establish its standing "with the manner and degree of evidence required at the successive stages of the litigation").

CAN does not qualify for this exception for two reasons. First, *Andreucetti* and the other cases discussing the exception seem to contemplate a nexus between the appeal and the possibility of a surplus—that is, that a favorable disposition of the objection or the appeal would itself create the possibility of a surplus. See, e.g., *In re Andreucetti*, 975 F.2d at 417. Here, even if we rescinded the sale of assets, as CAN requests, this would have no impact on the possibility of a surplus in the estate. As CAN concedes, the only events that could even theoretically result in a surplus for the estate are favorable outcomes in various other pending cases, contingencies which are entirely unrelated to the instant appeal. See Debtor's Resp. Br. at 8.

Second, Judge Barliant explicitly found that there was no reasonable possibility of a surplus in the estate, see Tr. at 3 ("The possibility that there will be a surplus in this estate is too remote to support standing as a party in interest."), and even apart from the deference we owe to this finding,⁸ our own review of the available evidence leads us to agree with Judge Barliant's assessment. Even aside from disputed or contingent liabilities related to pending cases, CAN's liabilities significantly exceed its assets. In the schedules filed pursuant to its original bankruptcy filing in October 1995, CAN claimed that it had assets amounting to \$56,223. See Schedules and Statement of Affairs, Summary Table (filed October 30, 1995). Its undisputed liabilities, however, amounted to \$268,177.⁹ *Id.* And the ratio of assets to liabilities has no doubt grown even smaller in the last 18 months

⁸ Given our present role as an appellate court, we owe no deference at all to Judge Barliant's ultimate legal conclusion that CAN lacks standing, and we therefore review this conclusion de novo. See *Meyer v. Rigdon*, 38 F.3d 1375, 1376 (7th Cir. 1994). But the finding that the possibility of a surplus in the estate is "remote" is essentially one of fact, and thus should be disturbed only if we find it to be clearly erroneous. *Id.*

⁹ We arrived at this figure by subtracting CAN's \$1,087,500 liability in the Scott case and its \$25,000,000 potential liability in the *Landmark Education Corp.* case—both of which CAN disputes—from its total listed liabilities.

due to the inevitable expenditure of estate assets in the course of these bankruptcy proceedings.

When the disputed liabilities related to pending cases are added to this picture it looks even worse. Jason Scott has obtained a judgment against CAN for \$1,087,500, though this judgment is on appeal to the Ninth Circuit. CAN may be liable for unknown but potentially large amounts in cases brought against it by Landmark Education Corp., Robert Lippman, Rick Ross, Charles Simpson, Mark Workman, and Marlene Hammerling, *see id.* (Schedule F), and even if CAN is ultimately found not liable to these parties it will still have to absorb the costs of defending against their claims. On the positive side, CAN claims that it may potentially obtain some damages from its suit against the Church of Scientology, but this suit was dismissed by the Circuit Court of Cook County and the dismissal was affirmed on appeal. The Illinois Supreme Court granted CAN's petition for leave to appeal, however, and heard argument on the appeal in March 1997.⁷

In sum, in order for there to be a possibility of a surplus in the estate after all of the creditors have been paid off, most if not all of the following events must occur: (1) the Ninth Circuit must reverse the judgment in the Scott case and absolve CAN of liability; (2) CAN must prevail in its appeal in the Illinois Supreme Court; (3) upon remand to the Circuit Court of Cook County, CAN must obtain a judgment against the Church of Scientology; and (4) the value of this judgment against the Church of Scientology must exceed the total amount of liability imposed on CAN in all the other lawsuits--including the Scott judgment

⁷ In its brief, CAN seems to suggest that Judge Barllant erred in failing to attempt to evaluate the particular strengths and weaknesses of each of these causes of action, thereby arriving at an estimate of their value. *See Resp. Br.* at 8. While this approach is sensible in theory, it is completely unworkable in practice. It would require an extraordinary expenditure of judicial resources to obtain and examine all the available briefs and evidence in these cases, even assuming it was possible to do so. And all this effort would result only in educated guesses by the bankruptcy judge. We think it was entirely appropriate for Judge Barllant to rely on the judgment of the person in the best position to evaluate the expected value of the pending cases--the estate's Trustee.

if it is not reversed—by enough to offset the undisputed liabilities of the estate. While this scenario is theoretically possible, we agree with Judge Barliant's view that CAN did not carry its burden of showing it to be a reasonable possibility, and even if we did not agree, his view is certainly not "clearly erroneous." Hence, CAN cannot avoid the general rule that chapter 7 debtors lack standing to object to or appeal from orders of the bankruptcy court. The motion to dismiss is granted with respect to CAN.

iii. Creditors' Waiver

As creditors of the estate, John Beal, Hagenbaugh & Murphy, and Davis Wright Tremain plainly have a pecuniary interest in any sale of assets by the Trustee, and therefore they have standing to present this appeal. Their arguments suffer from another fundamental defect, however: they were waived due to the creditors' failure to present them to the bankruptcy court.

It is settled law in this circuit that the failure of a party to adequately present an argument to the bankruptcy court constitutes a waiver of the argument. *See In re Bero*, 110 F.3d 462, 466 (7th Cir. 1997); *In re Weber*, 25 F.3d 413, 416 (7th Cir. 1994); *In re Kroner*, 953 F.2d 317, 319 (7th Cir. 1992). The creditors did not present to the bankruptcy court any of the objections they now raise regarding the sale of CAN's assets. Their failure to do so was emphasized by Judge Barliant in his ruling on CAN's standing, during which he stated: "I'm going to . . . grant the motion to authorize the sale. The principal ground on which I'm relying is that the debtor lacks standing to object to the sale, and no other creditor or party in interest has objected." Tr. at 3 (emphasis added).

The creditors make no attempt to excuse their waiver. Their substantive claims allege that the Trustee's notice of the sale was deficient in certain respects, but the three

creditors involved in this appeal received the notice,⁹ and thus had the opportunity to present objections to the sale (including the deficiency of the notice) to the bankruptcy court. Their failure to do so constitutes a waiver of their objections, and requires us to grant the motion to dismiss with respect to the creditors.⁹

IV. Conclusion

For the foregoing reasons, the motion to dismiss is granted. It is so ordered.



MARVIN E. ASPEN

United States District Judge

Dated

5/27/97

⁹ In their Joint Opening Brief (at 27) in the underlying appeal, the three creditors involved in this case acknowledge that they received the allegedly inadequate notice sent out by the Trustee. The service list accompanying the Notice of Motion and Intended Sale (dated October 16, 1996) corroborates this admission. See Hayes Br. Ex. L.

⁹ Our dismissal of this appeal under standing and waiver principles makes it unnecessary for us to consider whether this appeal is moot due to the appellants' failure to obtain a stay of the order authorizing the sale. See 11 U.S.C. § 363(m); *In re Andy Frein Servs. Inc.*, 798 F.2d 1113, 1125 (7th Cir. 1986) ("Section 363(m) requires that the party appealing an order approving a sale of property to a good faith purchaser obtain a stay of the sale pending appeal. . . . [A] would-be appellant's failure to obtain a stay . . . renders an appeal from the order authorizing and confirming the sale moot."). CAN and the creditors did not obtain a stay, but argue that § 363(m) is inapplicable because Steven Hayes was not a "good faith purchaser," and suggest that it was an abuse of discretion for the bankruptcy court to find that Hayes purchased in good faith without an evidentiary hearing. While the substance of this "good faith" question is fairly straightforward, some unresolved procedural questions lie in wait. For instance, under what circumstances is an appellant entitled to an evidentiary hearing on the question of good faith? If a hearing is held, should it be conducted by the district court (since the good faith question is related to its appellate jurisdiction) or by the bankruptcy court (which is in a better position to make this factual determination)? Compare *Plotner v. AT & T*, 172 B.R. 337, 341 (W.D. Okla. 1994) (district court can determine good faith), with *In re Weiboldt Stores, Inc.*, 92 B.R. 309, 313 (N.D. Ill. 1988) (district court should remand for a good faith determination). In view of these unresolved questions, we think the wiser course is to avoid engaging in a superfluous discussion of the question of good faith.

United States District Court

NORTHERN DISTRICT OF ILLINOIS

Eastern Division

JUDGMENT IN A CIVIL CASE

Cult Awareness Network, Inc.

v

CASE NUMBER : 97 C 80

Philip V. Martino

Jury verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the creditors did not present to the bankruptcy court any of the objections they now raise regarding the sale of CAN's assets. The creditors make no attempt to excuse their waiver. Their substantive claims allege that the Trustee's notice of the sale was deficient in certain respects, but the three creditors involved in this appeal received the notice, and thus had the opportunity to present objections to the sale, (including the deficiency of the notice) to the bankruptcy court. Their failure to do so constitutes a waiver of their objections, and requires us to grant the motion to dismiss with respect to the creditors. The motion to dismiss is granted.

May 27, 1997
Date

Michael W. Dobbins
Clerk

[Signature]
(By) Deputy Clerk

026-10

In the
United States Court of Appeals
For the Seventh Circuit

No. 97-3002

IN RE CULT AWARENESS NETWORK, INC.,

Debtor.

CULT AWARENESS NETWORK, INC.,

Debtor-Appellant.

and

JOHN M. BEAL, HAGENBAUGH & MURPHY,
and DAVIS WRIGHT TREMAINE,

Creditors-Appellants.

v.

PHILIP V. MARTINO,

Trustee-Appellee.

and

STEVEN L. HAYES, A LAW CORPORATION,

Intervenor-Appellee.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.
Nos. 97 C 80 and 97 C 416—Marvin E. Aspen, Chief Judge.

ARGUED APRIL 22, 1998—DECIDED JULY 30, 1998

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